Subject 400

Individual Retirement Accounts (IRA's)

An individual retirement account, is a personal savings plan that lets you set aside money for retirement, while offering certain tax advantages. To qualify for an IRA, you must have compensation. Generally, this includes wages, salaries, commissions, tips, bonuses, net income from self-employment, and an active partner's share of partnership income, if personal services are provided. Compensation usually does not include earnings and profits from property, such as rental income. Interest and dividend income is not compensation. Also, compensation does not include any amount received, such as pension or annuity income, or as deferred compensation. Once you decide you have compensation that qualifies for an IRA, you are concerned with 3 basic categories of IRA rules.

1) Contribution Rules
2) Rollover Rules, and
3) Distribution Rules

It is possible to make contributions to an IRA that is both deductible and non-deductible. Whether you can take a deduction depends on:

1) The amount of your adjusted gross income, and
2) Whether you are an active participant in an Employer Maintained Retirement Plan.

If you participate in an employer's retirement plan, or if you are married and file a joint return, or separately on the same return, and either one of you participates in an employer's retirement plan, the dollar limit on your IRA deduction may be reduced, depending on the amount of your modified adjusted gross income and whether that income falls within a "Phaseout Level".

Even though your deductible IRA contributions may be reduced or eliminated, you will be able to make nondeductible contributions to new or existing IRA's. Earnings on non-deductible and deductible contributions are not taxable until withdrawn. Two kinds of IRA's are:

1) An individual retirement account, and
2) An individual retirement annuity

The amount of deductible and, or, non-deductible cash contributions to your IRA that you can contribute are limited to the lesser of the following amounts: $2,000 or your compensation that must be included in income for the year.

If both you and your spouse work, and you each want to participate in an IRA, each of you may contribute to a separate IRA. If you file a joint return, or separately on the same return, you could deduct up to $4,000 of deductible or non-deductible contributions. However, if either or you is an active participant in a qualified plan, the annual gross income reported on your joint return must be less that $50,000 to qualify to make a deductible contribution to an IRA.

If you establish an IRA for your non-working spouse, you must file a joint return, or separately on the same return and establish two separate IRA's. You do not have to make equal contributions to each IRA, but you cannot contribute more that $2,000 to either IRA for the year. You must file a joint return, or separately on the same return, and he or she must choose to be treated as having no compensation for purposes of the IRA deduction.

The deadline for making a deductible or non-deductible contribution to an IRA for this current year, is the due date of your Federal return not including any of extensions of time to file.

You may choose to take a deduction for your IRA contribution before the contribution is actually made, provided you make it before the due date of your Federal return not including extensions.

Amounts you withdraw from your IRA, including earnings on your contributions to the IRA are fully or partially taxable in the year you withdraw them. If you have only deductible contributions, withdrawals are fully taxable. If you have both deductible and non-deductible contributions, withdrawals are partially taxable. You must use the general rule for pensions to Determine the taxable and non-taxable portions of the distribution.

Generally, amounts you withdraw before you reach 591/2 are subject to a penalty, unless you are permanently disabled.

Roth IRA

Contributions to a Roth IRA are not excluded from income but distributions and accumulated earnings are exempt from income tax if the funds are held for at least 5 years, and distributions are made after age 591/2. Each taxpayer may contribute up to $2,000 annually subject to phase out based on income limitations - Joint filers - $150,000 - $160,000; Single filers - $95,000 - $110,000. Converting a traditional IRA to a Roth results in taxable income; however, if the roll over occurred before 1999 the tax may be paid over 4 years. *Special note:

Taxpayers that have elected to pay the tax on the Roth conversion in the payment plan under Regulation 1998-2 are subject to having future refunds apply to the balance to satisfy the tax obligation. §26-36-303(5)

Education IRA

Joint filers with AGI of less that $150,000 may contribute up to $500 yearly to an account for the benefit of a minor. The contribution is not deductible, but the distribution of earnings is not taxed if used for the minor's post secondary education expense.